No. 12973

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

SHAFFER TERMINALS, INC.,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

UPON PETITION TO REVIEW A DECISION OF THE TAX COURT OF THE UNITED STATES

Brief of Petitioner

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INTRODUCTION

As set forth in the Petition for Review (R. 191 to 193), this is a petition to review a decision of the Tax Court of the United States affirming the determination by the Commissioner of Internal Revenue of deficiencies in Petitioner's excess profits taxes for the years 1944 and 1945, which determination was based solely on the disallowance as deductions of amounts paid by the Petitioner in those years for the rental of equipment required and used by it in the ordinary course of its business.

JURISDICTIONAL STATEMENT

Under date of September 23, 1949, the Commissioner of Internal Revenue issued his ninety-day letter advising the Petitioner, Shaffer Terminals, Inc., who will be hereinafter referred to as the "Petitioner," of the determination of deficiencies in excess profits taxes for the taxable years ended December 31, 1944, and December 31, 1945, aggregating $42,758.29 (R. 9). A petition for the redetermination of the deficiencies so announced was filed in the Tax Court of the United States December 12, 1949, pursuant to and in accordance with Internal Revenue Code, Section 272 (R. 5 to 15). Jurisdiction of such petition is conferred upon the Tax Court of the United States by I. R. C., Section 1101.

Petitioner's tax returns of the taxes in respect of which such deficiencies were determined were filed with the Collector of Internal Revenue for the District of Washington, at Tacoma, Washington (R. 19 and 172). The decision of the Tax Court was entered February 19, 1951, pursuant to findings of fact and the opinion of said court promulgated February 16, 1951 (R. 171 and 191). Petitioner's petition for the review of that decision was filed in the Tax Court May 9, 1951 (R. 191-193). Jurisdiction of such petition is conferred upon the U. S. Court of Appeals for the Ninth Circuit by I. R. C., Section 1141.

STATEMENT OF THE CASE

The case was heard by the Tax Court upon a stipulation of facts (R. 18 to 88) and the testimony of three witnesses for the petitioner, namely, K. M. Kennell (R. 98 to 117), Samuel B. Stocking (R. 117 to 127), and Eldon E. Searles (R. 131 to 170). The Commissioner offered no testimony. The facts, therefore, are not in dispute and, with the exception of particular findings which are the subject of specific assignments of error, were fairly found by the Tax Court. Briefly stated, they are as follows:

At the commencement of World War II and throughout the period here involved, Shaffer Terminals, Inc., a corporation with a capital of $20,000.00 only, was engaged in the business of operating warehouse terminals and storage facilities (R. 19). Its operations were conducted on leased properties for which it paid rental on a percentage basis, amounting to $110,796.86 in 1944 and to $73,107.56 in 1945. Its principal activity was the handling of cargo for the Federal Government, either lend-lease cargo destined for Russia or cargo for the Army and Navy Departments outward bound for Alaska or points in the Pacific Ocean (R. 21) and return salvage from the South Pacific. The proper and expeditious handling of that cargo required a certain type of equipment, namely, Clark Fork-Type Lift Trucks. At first,

Petitioner's requirements for this type of equipment had been supplied by rental from the United States Army, but with the understanding that such arrangement was temporary only.

In the middle of 1942, Petitioner's business increased very rapidly (R. 99) and with that increase came the need for additional equipment, particularly of the type mentioned. At the same time, Petitioner was continually under pressure to return or release the lift trucks rented from the Army. Prior to September 22, 1943, the Army gave Petitioner notice that this rented equipment was required for the Army's own use. The replacement of the equipment thus recaptured or to be recaptured by the Army was essential to the continuance of Petitioner's business and to meeting the demands made on it by the Army and other governmental agencies for the loading of cargo shipped over its terminal. Rental from others was unsuccessfully attempted. Acquisition seemed the only solution, but acquisition involved two problems, one, obtaining the priorities required by governmental regulations, and two, financing.

In the furtherance of the war effort, time was of the essence, and because Petitioner by reason of the work in which it was engaged was in position to secure the necessary priorities, it applied for and secured the priorities and ordered certain of this equipment before the problem of financing was solved.

Various methods of financing were considered and abandoned (R. 102, 103). One of the methods of financing so considered was the borrowing by the Petitioner from its bank of the funds necessary. This method was discouraged by the bank, which wanted the financing worked out some other way (R. 134). Such discouragement in banking practice is tantamount to advance notice that a formal application for a loan would be turned down; consequently no such application was made.

In this situation, confronted by the paramount necessity of obtaining additional equipment and by the necessity that arrangement had to be made for payment for the equipment already ordered, the stockholders of Petitioner, on or about September 22, 1943, formed an unlimited partnership known as Equipment Associates. The interests of the individuals in the corporation were decidedly unequal, but in the partnership their interests were equal, and respectively as follows:

Individual	*Interest in Petitioner Corporation*		*Interest in Partnership*
	Number of Shares	*Percentage of Interest*	
R. H. Shaffer	105	54%	25%
S. B. Stocking	72	36%	25%
K. M. Kennell	12	6%	25%
W. Hopkins	8	4%	25%

Less than a month later R. H. Shaffer died and his interests in both the Petitioner corporation and the part-

nership were acquired by the other three, the former unequally, the latter equally, so that on December 31, 1943, and thereafter, the respective interests in the corporation and partnership were:

Individual	*Interest in Petitioner Corporation*		*Interest in Partnership*
	Number of Shares	*Percentage of Interest*	
S. B. Stocking	157	78½%	One-third
K. M. Kennell	26	13%	One-third
W. Hopkins	17	8½%	One-third

The partnership thus formed was decided upon without consideration of the tax effect or consultation with either the corporation's attorney or its tax accountant and was formed solely for the purpose of acquiring the equipment required by the Petitioner in the performance of its war work and the leasing of such equipment to the Petitioner as Petitioner's needs required. (See Paragraph 2, Partnership Agreement, R. 27.) The initial capital of the partnership, Equipment Associates, was $10,000.00, contributed equally by the original four partners. Hopkins, who as a stockholder in Petitioner had only a 4% interest therein, contributed his $2500.00 from funds he then had on hand. Kennell, whose stock holding in Petitioner represented only a 6% interest therein, contributed his $2500.00 to the initial capital of the partnership partially from his own funds and partially from moneys borrowed on his individual credit. The other partners' contributions were made from loans

made to them on their individual credit. The initial purchase of equipment was made with the capital so contributed. Subsequent purchases were made by the partnership with funds borrowed by the partnership, with each partner liable for the entire debt even though such loans were secured by chattel mortgages on the equipment of the partnership. It is unreasonable to suppose that the individual stockholders would have assumed such a personal liability for the corporation, wherein their interests were at the time respectively 78½ per cent, 13 per cent and 8½ per cent.

The equipment so acquired was leased to Petitioner under written agreements (R. 30). The deductibility of the rental paid by the Petitioner therefor in the determination of its excess profits tax liability is the sole question here presented. There is involved no question as to the reasonableness of such rentals. They were in accord with tariffs filed with the Public Service Commission of the State of Washington in compliance with Section 10383 of Remington's Revised Statutes. They were at the same rates and terms as the rentals paid during the years involved to the United States Army for the same type of equipment (R. 33, 34 and 100). The deductibility of the rental paid to the Army and others in the same years is unquestioned, and if the rental paid to the partnership had been paid either to the Army or others it would not have been questioned.

The partnership continued in business until June 30, 1947, when it was dissolved and liquidated (R. 183). During that time it functioned independently of the Petitioner, borrowing money, maintaining its own bank accounts, purchasing equipment with its own funds, and leasing such equipment as opportunity offered, principally to the Petitioner but also to third parties (R. 34), and paying social security, business and occupational taxes, and personal property taxes. It filed income tax returns covering that period, showing equal distribution of the partnership profits, on account of which the partners individually paid increased income taxes. Now the Government seeks additional taxes from the corporation on account of the profits on which the partners have already paid taxes. Upon liquidation of the partnership, Petitioner bought for its then depreciated value the partnership equipment, although it was under no obligation so to do (R. 30).

ASSIGNMENTS OF ERROR

1. The Tax Court erred in holding that the sale and lease agreements between Petitioner and the partnership, Equipment Associates, did not constitute sale and lease transactions recognizable for tax purposes.

2. The Tax Court erred in holding that the rentals paid by Petitioner to Equipment Associates are not proper and allowable deductions under Section 23(a)-

(1)(A) of the Internal Revenue Code in the computation of Petitioner's excess profits taxes.

3. The Tax Court erred in deciding "that there are deficiencies in excess profits taxes for the years 1944 and 1945 in the amounts of $20,537.77 and $22,220.52 respectively."

4. The Tax Court erred in finding as a fact that Petitioner's arrangements for the handling of cargo, and particularly lend-lease cargo destined for Russia, were in 1942 and 1943 "expected to . . . continue for the duration of the war." (R. 173).

5. The Tax Court erred in finding as a fact that the partnership, Equipment Associates, was organized "primarily to avoid the excess profits tax and its impact on the earnings of Petitioner. It was not organized for the purpose of financing the purchase of equipment which Petitioner needed in its business." (R. 184).

6. The Tax Court erred in finding and holding that "the testimony of E. E. Sarles . . ., although contradictory, is to the effect that petitioner would have been granted a short-term loan had it made application." (R. 186).

7. The Tax Court erred in finding and holding that the partnership was an agency created by Petitioner and subservient to it from which independence and control had been stripped. (R. 190).

ARGUMENT

On the main issue whether the rentals paid by Petitioner to the partnership are proper deductions in the computation of excess profits tax, which issue is presented by Assignments of Error Nos. 1, 2 and 3, Petitioner's claim that the Commissioner and the Tax Court erred in the disallowance of such deductions rests upon the following propositions:

(a) A taxpayer has the right to decrease his tax liability by any lawful means.

Gregory v. Helvering, 293 U.S. 465, 79 L. Ed. 596;

Jones v. Helvering, 63 App. D. C. 240, 71 Fed. (2d) 214, at 217; Cert. denied, 293 U. S. 583, 79 L. Ed. 679.

(b) In so doing a taxpayer has the right "to adopt the type of organization he deems to be suitable and preferable."

Coca Cola Bottling Co. of Sacramento, Ltd. v. Commissioner, 17 Tax Court........, No. 14, promulgated July 31, 1951;

Moline Properties, Inc. v. Commissioner, 319 U. S. 436, 87 L. Ed. 1499;

Twin Oaks Co. v. Commissioner, 183 Fed.(2d) 385 (C.C.A. 9th).

(c) The partnership and the Petitioner were separate entities.

Moline Properties, Inc. v. Commissioner, 319 U. S. 436, 87 L. Ed. 1499;

National Investors Corp. v. Hoey, 144 Fed.(2d) 466 (C.C.A. 2nd);

Twin Oaks Co. v. Commissioner, 183 Fed(2d) 385 (C.C.A. 9th);

John L. Denning & Co. v. Commissioner, 180 Fed(2d) 288, (C.C.A. 10th);

Coca Cola Bottling Co. of Sacramento, Ltd. v. Commissioner, 17 Tax Court....., No. 14.

(d) Being separate entities, the transactions between them cannot be disregarded for tax purposes because those transactions changed the flow of economic benefits.

Higgins v. Smith, 308 U. S. 437, 84 L. Ed. 406;

Commissioner v. Greenspun, 156 Fed(2d) 917;

Twin Oaks Co. v. Commissioner, 183 Fed.(2d) 385;

Brown v. Commissioner, 180 Fed.(2d) 926 (C.C. A. 3rd);

Skemp v. Commissioner, 168 Fed.(2d) 598 (C.C. A. 7th);

Shirley v. O'Malley, 91 Fed. Supp. 98.

We shall not labor the first two of the foregoing propositions. Both are now firmly established in the law of income and related taxes, and the first is conceded by the Tax Court.

The authoritative test of separate taxable entities is prescribed by the Supreme Court in the *Moline Properties Company case,* 319 U. S. at 438, 87 L. Ed. at p. 1502, as follows:

> "The doctrine of corporate entity fills a useful purpose in business life. Whether the purpose be to gain an advantage under the law of the state of incorporation or to avoid or to comply with the demands of the creditors or to serve the creator's personal or undisclosed convenience, so long as that purpose is the equivalent of business activity or is followed by the carrying on of business by the corporation, the corporation remains a separate taxable entity."

In *National Investors Corporation v. Hoey,* 144 Fed. (2d) at 467, Judge Learned Hand ,after pointing out the errors made by the Circuit Court of Appeals for the Second Circuit in interpreting and applying prior decisions of the Supreme Court of the United States, said of the test prescribed in the Moline Properties case and above quoted:

> "The gloss then put upon *Higgins v. Smith, supra,* was deliberate and is authoritative: it was that, whatever the purpose of organizing the corporation, 'so long as that purpose is the equivalent of business

activity or is followed by the carrying on of business by the corporation, the corporation remains a separate taxable entity'."

These tests have been applied in determining the separable taxable entity of a corporation from that of a partnership formed by the stockholders of the corporation. Thus, Judge Harron, in delivering the majority opinion of the Tax Court in the *Coca Cola Bottling Company case, supra*, which was promulgated July 31, 1951, said:

> "The members of the partnership are subject to the unlimited personal liability which may develop out of the operation of the business by the partnership in place of the limited liability to which they had been subject previously as stockholders of Sacramento Company when it conducted the bottling and distributing business. The change in personal liability is evidence of the reality in the change of the form of the entity which thereafter operated the business."

In *John L. Denning & Co. v. Commissioner, supra*, Chief Justice Phillips, in delivering the unanimous opinion of the 10th Circuit, said, 180 Fed.(2d) page 290:

> "We think there could be no doubt on the undisputed facts in the record that the partnership served an independent business purpose. It was owned, its capital was subscribed, and its credit was provided by three minority stockholders in the corporation. It purchased and sold broom corn. It owned its own warehouse. In so far as it used office space, facilities and employees of the corporation. and warehouse storage, it paid full value therefor

and was not favored. The corporation and the partnership kept separate books and records and the books and records of the partnership clearly reflected the business transacted by it and the income earned by it. It was organized primarily for the purpose of enabling Mrs. Effie Denning to employ her own capital and utilize her knowledge in the broom corn business at a particularly advantageous time in that business. It served a legitimate business purpose. It was not a sham. Under the undisputed facts on this record we do not think the separate entity of the corporation and the partnership may be disregarded."

In the case of *Twin Oaks Company v. Commissioner*, 183 Fed(2d) 385, decided by this Court July 20, 1950, the facts were that the stockholders of a corporation, after its operations for some time had resulted in unsatisfactory profits, "executed a partnership agreement whereby the four, as equal partners, would take over the business of the corporation," purchasing its operating assets and leasing from it the real estate on which the business had been and was then being conducted, but keeping the corporation alive "for the sole purpose of holding title to the real estate." This Court found as controlling facts that the partnership was actually formed, that the stockholders were, as members of the partnership, subjected to unlimited personal liability for the partnership debts, that the profits of the business of the partnership were thereafter distributed to the partners equally and not in proportion to their respective stock holdings in the corporation (all of which facts are present here), and held:

> "These changes, all made without thought of or intent to achieve tax advantages, were, we think, far more than mere changes in form. The Tax Court felt that the fact that the profits were distributed in a different manner and in different proportions, but to the same people, indicated that the changes were formal only. The logic of this position escapes us, for it ignores the reality of the conversion from corporate to partnership operation of the business and tends in no way to show that the corporation rather than the partnership earned the income." (Opin. 183 Fed.(2d) p. 387).

In the instant case, the partnership, Equipment Associates, formed by the stockholders of the Petitioner corporation meets all the tests of a separate taxable entity. It was actually formed. There was no fraud in its formation or subsequent business activities. Its initial capital was contributed equally by the partners and in shares utterly disproportionate to their stock holdings in Petitioner. It was recognized as a separate entity by the Bank from which it borrowed money, for the repayment of which each partner was individually fully liable. It was recognized as a separate entity by the taxing authorities of the State of Washington, to which it paid social security and business or occupational taxes. and by the taxing authorities of the United States, to which it made income tax returns, and it distributed its profits equally to its members.

The Tax Court did not find that the Petitioner and the partnership were not separate entities. It did not

find that the organization of the partnership was not "followed by the carrying on of business" by it. It made no finding on either of these points, although the facts that the Petitioner and the partnership were separate entities and that after its organization the partnership carried on business are established beyond question by the record. On the contrary, the Tax Court found:

> "The stockholders of Petitioner organized the partnership primarily to avoid the excess profits tax and its impact on the earnings of Petitioner." (R. 184).

This finding is clearly erroneous because directly contrary to unimpeached and wholly uncontradicted testimony. It is the subject of a special assignment of error and will be discussed in more detail later. But, even if warranted, it is a finding as to purpose or motive. Since the decision in *Moline Properties, Inc. v. Commissioner,* 319 U. S. 436, 87 L. Ed. 1499, purpose, at least in the absence of fraud, is immaterial "so long as that purpose is the equivalent of business activity or is followed by the carrying on of business."

(d) The transaction between Petitioner and the partnership changed the flow of economic benefits.

The Tax Court rested its decision upon the conclusion:

> "Upon close scrutiny, this entire plan is not, in

> substance, a sale and lease transaction recognizable for tax purposes . . . ." (R. 189).

In turn, it based that conclusion on the proposition that "control over the property (i.e., the equipment of the partnership, Equipment Associates) remained in Petitioner." (R. 187).

The Tax Court purported to make a realistic approach to the question of tax liability upon the principle said by it to have been initiated by the Supreme Court of the United States in *Gregory v. Helvering*, 293 U. S. 465, 79 L. Ed. 596, namely: "Whether the transaction under scrutiny is in substance what it purports to be in form." (R. 187). The principle so broadly stated was repudiated by the Supreme Court in *Higgins v. Smith*, 308 U. S. 437, 84 L. Ed. 406, in the following language:

> "The Government urges that the principle underlying *Gregory v. Helvering* finds expression in the rule calling for a realistic approach to tax situations. As so broad and unchallenged a principle furnishes only a general direction, it is of little value in the solution of tax problems. If, on the other hand, the Gregory case is viewed as a precedent for the disregard of a transfer of assets without a business purpose but solely to reduce tax liability, it gives support to the natural conclusion that transactions, which do not vary control or change the flow of economic benefits, are to be dismissed from consideration."
>
> (Opin. 308 U. S., p. 476, 84 L. Ed. 410).

Conversely stated, the principle or rule established by *Higgins v. Smith* is that transactions which either vary control or change the flow of economic benefits are not to be disregarded in the determination of tax liability. The rule was so interpreted by the Circuit Court of Appeals for the Fifth Circuit in *Commissioner of Internal Revenue v. Greenspun,* 156 Fed.(2d) 917, when it held:

> "The Tax Court, we think correctly interpreted *Higgins v. Smith, supra,* . . . as authority, in short, for the view that transactions which do not in reality vary control, or change the business aspects of a situation are to be dismissed from consideration in determining tax incidents." (Opin. 156 Fed.(2d) 920).

The rule or principle so interpreted was applied by this Court in *Twin Oaks Company v. Commissioner,* 183 Fed.(2d) 385.

See also:

Brown v. Commissioner, 180 Fed.(2d) 926 (C.C.A. 3rd);

Ross v. Commissioner, 129 Fed.(2d) 310 (C.C.A. 5th);

Shirley v. O'Malley, 91 Fed. Supp. 98 (D.C.D. Nebr.)

The present case falls within and is governed by that rule, because it is indisputable that the transactions between the Petitioner and the partnership, Equipment

Associates, changed the flow of economic benefits. (See Findings of the Tax Court, R. 182-3).

The Tax Court wholly disregarded the fact of the change in the flow of economic benefits effected by these transactions and rested its decision upon the proposition that there was in fact no change in the control of the equipment. Under the rule here being considered, the existence of *either* a change in control *or* a change in the flow of economic benefits precludes disregard of the transaction in determining tax incidents.

Undoubtedly it will be contended that the decision of the Tax Court is supported by *W. H. Armston Co. v. Commissioner,* 188 Fed.(2d) 531 (C.C.A. 5th). That case is clearly distinguishable. There, the transaction was between a corporation and its principal stockholder, Catherine Armston, who, with her husband, "owned virtually all of the stock in W. H. Armston Co., Inc." The transaction worked no change in the flow of economic benefits. Furthermore, in that case the corporation had in previous years acquired the equipment which it sold to Catherine Armston and there was not present the problem of financing additional equipment needed by the corporation. Her purchase thereof was not financed with her own funds or personal credit independent of the corporation, but on security of stock in the corporation pledged by her. Here, the initial purchase of equipment by the partnership was financed by the partnership,

wholly independently of the corporation and with capital contributed equally to the partnership by each of the partners wholly from his own funds either previously accumulated or secured on his personal credit. Subsequent purchases by the partnership were financed by it independently of Petitioner (R. 177).

Upon the issue whether the transactions between Petitioner and the partnership are recognizable for tax purposes, we submit the case is in all essential particulars parallel to and governed by the decision of this Court in *Twin Oaks Co. v. Commissioner,* 183 Fed.(2d) 385. The following language from Judge Lindley's opinion in that case applies with full force here, namely:

> "It seems clear to us, however, that the Tax Court, in its characterization of the change in business structure involved in the instant case as sham and a mere form without substance, has, in effect denied the taxpayers the legal right to conduct their business affairs through a medium of their own choice."

ASSIGNMENTS OF ERROR AS TO PARTICULAR FINDINGS

In considering these assignments of error, namely, Assignments of Error 4 to 7, inclusive, it is to be remembered, (1) that the Commissioner offered no testimony, and (2) that the decision of the Tax Court was by a single judge.

In general, these several assignments of error as to particular findings or holdings of the Tax Court are based upon the following propositions of law:

> "The finding is 'clearly erroneous' when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed."

U. S. v. U. S. Gypsum Co., 33 U. S. 364, 395, 92 L. Ed. 746, 766.

> "It is axiomatic that uncontradicted testimony must be followed."

Grace Bros. v. Commissioner, 173 Fed.(2d) 170, at 174 (C.C.A. 9th).

> "It (the Tax Court) may not arbitrarily discredit and disregard unimpeached, competent and relevant testimony of a taxpayer which is uncontradicted."

A & A Tool & Supply Co. v. Commissioner, 182 Fed.(2d) 300, at 304 (C.C.A. 10th).

See also:

J. H. Robinson Truck Lines v. Commissioner, 183 Fed.(2d) 739 (C.C.A. 5th).

The finding that Petitioner's arrangements for the handling of cargo were "expected to . . . continue for the duration of the war" (Assignment of Error 4) is directly contrary to the competent, relevant, unimpeached and uncontradicted testimony of K. M. Kennell.

He testified in respect to the duration of the use of the equipment purchased by the partnership, as follows:

> "A use for it might be ended at any time. It was in this lend-lease operation with Russia, to Vladivostok and similar points on the Pacific Coast of Siberia. The threat of the Japanese interrupting that lend-lease line was ever present, and no one knew from one day to the next whether that line was going to be permitted to stay open or not." (R. 105).

and on cross-examination Mr. Kennell testified that Petitioner was operating under no contracts but simply an arrangement under which "we handled cargo they sent to us day by day." To the question asked by Mr. Picco:

> "But you expected and contemplated and expected that this arrangement would continue during the duration of the war period, did you not?"

he answered:

> "In part, that may be true, sir, but as I explained in answer to the question a moment ago, no one knew how long the Russian supply line would be left open, that was in the hands of the Japanese." (R. 107).

Likewise, the finding that the partnership was organized "primarily to avoid the excess profits tax" and not "for the purpose of financing the purchase of equipment which Petitioner needed in its business," (Assignment

of Error 5) is directly contrary to the testimony of the said K. M. Kennell. He testified, without impeachment or contradiction, that in August of 1943 "We (the Petitioner) were already borrowing as heavily as we could hope to, from the bank, because of the tremendous amounts of accounts receivable we were having to carry," (R. 103) and "The corporation's net returns in any year during that period could not possibly sustain the investment that would be necessary in equipment." (R. 105).

In this he is fully corroborated by the testimony of Mr. E. E. Searles, Vice-President of Puget Sound National Bank (R. 138, 140, 163, 168).

Mr. Kennell further testified that the purpose of the partnership, Equipment Associates, was the financing of the acquisition of the lift-truck type of equipment (R. 117), and in this he is corroborated by paragraph 2 of the Partnership Agreement (R. 27). On cross-examination he testified as follows:

> Q. Why was it necessary to form this partnership, if all the answers you have given me are true?
>
> A. The answer, Mr. Picco, is quite obvious. That is, that our net position was not going to be sufficient to permit us to finance this equipment, plus other equipment that was contemplated with other business that was being considered for us by the Army and others, and the necessity of tying up so much of our funds in the nature of accounts receivable and other forms of working capital. (R. 108-9).

Q. Actually, is it not true that the only reason for forming that partnership was to operate (exclude or reduce) the excess profits tax from these payments?

A. Had that been our intention, sir, we would have changed our corporation to a partnership and taken the benefit of it on all our other transactions. (R. 110).

Further, on cross examination, he testified in effect that the Bank definitely indicated that it was not in a position to loan money to the Petitioner for the equipment in addition to the loans they were then carrying, that an equipment loan would be a capital loan and they could not see where the Petitioner could earn the money to repay it; that their banker did not say "he would not loan at all. He said it wasn't the proper loan to make at that time." (R. 112).

As to the finding that the testimony of E. E. Searles "is to the effect that Petitioner would have been granted a short-term loan had it made application" (Assignment of Error 6) we submit that on a careful reading and consideration of Mr. Searle's testimony (R. 129 to 170) this Court will be convinced that the finding is unjustified and clearly erroneous.

Searles at no time testified that in 1943 a loan to purchase equipment would have been made to Petitioner if it had applied therefor. Quite the contrary. In the

initial discussion regarding the financing of the acquisition of the needed equipment, he "discouraged the borrowing by the Corporation," (R. 134) and again to the same effect (R. 140). As previously stated, a banker's discouragement is but his polite way of serving notice that formal application for such loan would be useless. He further testified, in response to the question whether the Bank would have made loans to the Petitioner for the same purpose and on the same basis as they did to the partners of Equipment Associates and to the partnership:

> "No, I don't think we would, because they were not entitled to it." (R. 138).

On cross-examination he testified that he would not have recommended a loan of approximately $9,500.00 to the Petitioner in September and October of 1943. He said, "It might have gone through, but I would not have recommended it." (R. 142) See also his testimony R. 148 and 154.

On his redirect examination the following occurred:

> Q. You said definitely you would not recommend a loan to Shaffer Terminals on a question of credit, but you said it might have gone through. Do loans normally go through against your recommendation?
>
> A. Oh, no, not against recommendation, no. Normally they do not, no.

Q. It would be a very unusual thing if the loan would have gone through?

A. It would be, with the senior officer recommending. (R. 163).

And on recross examination he reiterated that if the Petitioner had come in for a loan in September or October of 1943 and if he knew that the purpose of that loan was to buy equipment, he would not have recommended the loan (R. 168).

The most that can be said for his testimony is that under adroit cross examination he came close to saying, but did not actually say, that if in September or October of 1943 he, or the Bank, had known or could have foreseen the results of Petitioner's operations during the years 1944 or 1945 (R. 164-5) the Bank might have made an equipment loan to Petitioner if all the stockholders had endorsed the paper (R. 169-70).

As to the finding or holding that the partnership was a subservient agency created by Petitioner from which independence and control had been stripped (Assignment of Error 7), we submit that it has been demonstrated under our discussion of the proposition that the Petitioner and the partnership were separate taxable agencies, that the partnership was not created by the corporation but was at all times a separate and independent jural and taxable entity. Accordingly, this par-

ticular finding or conclusion, whatever it may be, is also clearly erroneous.

There being no question that the rents paid by Petitioner to Equipment Associates were not excessive or that Petitioner was legally obligated to pay the same, or that rents paid in the ordinary course of business are allowable deductions in the computation of excess profits taxes under Section 23(a)(1)(A) of the Internal Revenue Code, we submit the decision of the Tax Court should be reversed and either the deficiencies in Petitioner's excess profits taxes for the years 1944 and 1945 expunged, or the case remanded to the Tax Court with directions to enter judgment in accordance with the prayer of Petitioner's petition to that Court to review the Commissioner's determination in respect of such deficiencies.

Respectfully submitted,

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